

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM  
STATEMENT OF INVESTMENT POLICY**

**FOR  
EQUITY REAL ESTATE JOINT VENTURES**

**August 16, 2004**

*This Policy is effective upon adoption and supersedes all previous joint venture policies.*

**I. PURPOSE**

This document sets forth the investment policy ("the Policy") for the Equity Real Estate Joint Ventures Program ("the Program"). The design of this Policy ensures that investors, managers, consultants, or other participants selected by the California Public Employees' Retirement System ("the System") take prudent and careful action while managing the Program. Additionally, use of this Policy provides assurance that there is sufficient flexibility in controlling investment risks and capturing returns associated with this segment of the market.

This Policy applies to existing and future joint ventures. However, a number of existing joint ventures do not comply with the Policy. In cases where existing joint ventures do not comply, all efforts shall be used to restructure such agreements and otherwise manage the investment to maximize return notwithstanding existing limitations. A list of non-compliant joint ventures shall be maintained in the Staff Procedures Manual.

**II. STRATEGIC OBJECTIVE**

The System shall make joint venture investments in equity real estate ("Joint Ventures") under specified conditions and circumstances as described in this Policy.

Joint Ventures in existing properties shall achieve a minimum long-term real rate of return consistent with the overall return objectives of the Equity Real Estate Portfolio ("the Portfolio") and the overall risk of the particular investments. Joint Ventures in development projects shall be expected to achieve higher returns due to increased risks. In either case, investment selection shall be oriented to the preservation of capital and achievement of real rates of return.

### III. INVESTMENT POLICY

The System's Real Estate Investment Managers may negotiate Joint Ventures with the following types of co-venturers:

- A. Developers
- B. Institutional Investors/Owners
- C. REITS
- D. Limited Liability Companies
- E. Operating Companies

However, terms and conditions of a Joint Venture agreement ("Agreement") are subject to prior approval by the System's Senior Real Estate Investment Officer and General Counsel or designated counsel.

Joint Ventures may be direct co-investments in existing, substantially leased or development properties, in accordance with policies established in the System's Statement of Investment Objectives and Policies for Development Investments.

Joint Ventures may be structured as limited liability companies, limited partnerships, corporations, REITS, and other formats. Additionally, Joint Ventures shall be subject to the investment policies in accordance with the System's Statement of Investment Objectives and Policies for the Equity Real Estate Portfolio.

#### A. **Leverage**

Regarding core assets only, leveraged Joint Ventures are permitted to the extent that sufficient financial and pragmatic consideration is given to the increased risk and return characteristics for the investment of the underlying debt financing. The System shall make decisions for entering into leveraged Joint Ventures or for leveraging a Joint Venture in accordance with its Statement of Equity Real Estate Leverage Policy.

#### B. **Distributions**

The basis of distributions (e.g., net cash flow, net income, or gross income) shall be carefully defined in the Agreement(s) governing the Joint Venture, with the understanding that the basis of such allocation shall take into consideration the relative equity

investment, management and oversight responsibilities and tax positions of the joint venturers. Distributions shall be paid at least quarterly, and preferably on a monthly basis. The System generally prefers distributions based on income after expenses, net of a provision for reserves for payment of property taxes and anticipated repairs and capital improvements.

**C. Contributions**

The Agreement shall specify the amount, extent and timing of each joint venturer's contribution (in property, cash, credit, or services) to the Joint Venture. It is anticipated that a managing joint venturer shall have capital at risk that is material to that joint venturer. Both joint venturers shall make additional contributions in proportion to their ownership percentages or as stated in the Agreement. If a joint venturer is unable to meet its contribution requirement, such an event shall generally be treated as a default, and the Agreement shall provide for remedies.

In cases where the System has both equity and debt investment in the Joint Venture, the Agreement shall provide that the System is not obligated to provide additional contributions to fund debt service payments. However, the System shall have the ability to do so if the additional contributions preserve its right as a lender.

**D. Responsibilities of Joint Venturers**

All Agreements shall specify the roles and responsibilities of each of the joint venturers. Responsibilities shall include executing asset management decisions for the Joint Ventures, overseeing or providing daily property management services, reporting results to others, and other specific services.

**E. Resolution of Disputes**

Provision for resolution of disputes among joint venturers shall be specifically defined in the Agreement. Alternative means of resolution for different types of disputes shall be specified in the Agreement(s), along with the respective rights and responsibilities of the various participants.

**F. Transfer of Interests**

Joint venturers may transfer their interests to another joint venturer or to third parties. The Agreement shall provide the System with a right of first offer, and the right to approve new joint venturers. The

System shall seek to obtain a right of first refusal, which would apply in the event the System's co-venturer desires to sell its interest. Conversely, the System shall avoid granting its co-venturer a right of first refusal. It shall do so only after full consideration of the impact on the marketability, and ultimately the value, of the System's interest. The System must retain the right to buy out its co-venturer(s) in Joint Venture agreements and shall consider incorporating a buy/sell agreement where necessary to ensure this right.

**G. Construction Overruns**

For development Joint Venture projects, the System shall have the right to approve the proposed construction budget and shall negotiate provisions to minimize the impact of possible cost overruns on the System in the Agreement. However, in some cases, it may be appropriate for the System to fund approved construction cost overruns, although the System shall not be obligated to contribute.

**H. Investment Control**

The System shall seek to obtain a controlling interest in Joint Ventures in order to have the greatest possible degree of control over its investment. The System shall retain a level of control over property management and major decisions consistent with its economic interest in the investment.

**IV. ASSET MANAGEMENT**

The Investment Manager or an affiliate may be the System's partner in a Joint Venture. Alternatively, the Investment Manager may be a third party retained to represent the System in a Joint Venture. In either role, the Investment Manager shall act as a fiduciary to the System when representing the System's interest as its asset manager in the Joint Venture. In this case, the fee structure for property management services shall require the approval of the System's staff. If the property manager is affiliated with the System's Investment Manager, the fee structure for property management services shall require the approval of the System's staff. Asset and property management may be transferred from the Investment Manager to another of the System's Investment Managers, or a third party, at the sole discretion of the System's Senior Real Estate Investment Officer.

Reporting and accounting procedures for the Joint Venture must be established to meet the System's current reporting and accounting

standards and policies. The System shall have the right to have independent certified audits of the Joint Venture accounting records and property documents. The Agreement shall require that the managing partner provide the System with enough information for adequately tracking the performance of the assets in the Joint Venture as well as the System's interest.

Joint Venture properties shall be insured under the System's Risk and Insurance Program if the System deems it to be the most extensive and cost efficient insurance coverage obtainable.

The System reserves the right to review the selection of the Joint Venture's attorney, accountants, consultants, and other third-party advisors, with the System retaining the right as co-venturer to review and approve all documents prepared by outside parties.

## **V. SELECTION OF JOINT VENTURERS**

Potential development company, limited liability corporation, and operating company joint venturers are to be evaluated by the System's Investment Manager based on past development and asset management experience with similar projects, and financial stability. Potential institutional investor and REIT joint venturers are to be evaluated based on their size, financial stability, alignment of interests with the System, and commitment to a long-term real estate investment.

## **VI. DEVELOPMENT FEES**

Payment of development fees to developer joint venturers shall be subject to negotiation and may reflect reimbursement of overhead costs and reasonable profit. Approval of actual development fees to developer joint venturers shall be at the sole discretion of the System's Senior Real Estate Investment Officer.

## **VII. GLOSSARY OF TERMS**

The Real Estate Glossary of Terms is referenced in the System's Master Glossary of Terms.